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IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

LASZLO N. TAUBER, *et al.*,

Petitioners,

v.

COMMONWEALTH OF VIRGINIA, *et al.*,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Virginia

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BRIEF FOR AMICI CURIAE AMERICAN COUNCIL ON EDUCATION AND NATIONAL ASSOCIATION OF STATE UNIVERSITIES AND LAND GRANT COLLEGES IN SUPPORT OF PETITIONERS

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BRIEF FOR AMICI CURIAE AMERICAN COUNCIL ON EDUCATION AND NATIONAL ASSOCIATION OF STATE UNIVERSITIES AND LAND GRANT COLLEGES IN SUPPORT OF PETITIONERS

STATEMENT OF INTEREST OF AMICI CURIAE

The American Council on Education ("ACE"), founded in 1918, represents approximately 1,800 public and private colleges and universities across the United States, as well as over 175 non-profit education associations and organizations. ACE's principal purpose is to further the goals of higher education, including the interests of component groups of the academic community: students, faculty, administration, and employees. The National Association of State Universities and Land Grant Colleges represents 195 public universities and land grant institutions. The Association supports high-quality public higher education and serves its member

institutions as they perform their traditional teaching, research and public service roles. [1]

Amici wish to apprise the Court of the significance of this case for institutions they represent. The decision of the Virginia Supreme Court to apply *Virginia* corporate law to a *Maryland* corporation portends that the conduct of boards of nonprofit entities, including the boards of *amici*'s member colleges and universities, will be judged according to the fiduciary standards of every single state in which the nonprofit entities operate. This is a marked departure from this Court's prior case law, and poses no small danger to the operations and innovations of *amici*'s member institutions.

SUMMARY OF ARGUMENT

The application of Virginia corporate law to the internal decisionmaking of a foreign corporation is cause for alarm among many nonprofit groups and higher education institutions. Traditional geographic boundaries for colleges and universities are becoming increasingly flexible; more and more colleges, universities, and other nonprofit organizations operate extension programs in locations other than their states of incorporation, and advances in technology are facilitating development of distance education available through the Internet. As the law stood prior to the Virginia Supreme Court's decision, *amici*'s members could safely rely on the laws of their respective states of incorporation for guidance in their corporate decisionmaking. If the decision of the Virginia Supreme Court stands, many nonprofit organizations will be obliged before making a corporate decision to consult not only the law of their states of incorporation, but the laws of each and every one of the states in which they have a presence, entailing at best burdensome

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[1] Pursuant to Supreme Court Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part and no person, other than *amici* or their counsel, made a monetary contribution to the preparation or submission of the brief. This brief is submitted with the consent of all of the parties, whose letters of consent have been lodged with the Clerk.

inefficiencies in institutional governance, and at worst irreconcilable conflicts among the laws of several states. This Court should grant certiorari to clarify that the laws of the state of incorporation, *not* the laws of every state in which a corporation maintains any presence, govern that corporation's internal decisionmaking.

ARGUMENT

I. APPLYING LOCAL FIDUCIARY STANDARDS TO FOREIGN CORPORATIONS VIOLATES THE CONSTITUTION AND THIS COURT'S CASE LAW.

This Court has held time and again that "the law of the state of incorporation normally determines issues relating to the internal affairs of a corporation." *First Nat. City Bank* v. *Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 621 (1983); *see also Rogers* v. *Guaranty Trust Co. of N.Y.*, 288 U.S. 123, 130 (1933) ("It has long been settled doctrine that a court—state or federal—sitting in one State will * * * decline to interfere with * * * the management of the internal affairs of a corporation organized under the laws of another State."). While it is often the case that more than one state has an interest in regulating a corporation's affairs—many corporations, after all, do business in more than one state—the courts have consistently held that the need for certainty and uniformity in internal corporate decisionmaking takes precedence over the regulatory interests of a foreign state.[2] As one court recently noted, "[a] single rule for each corporation's internal affairs reduces uncertainty and the prospect of inconsistent obligations; it also enables the corporate venturers to adjust the many variables of corporate life * * * confident that they can predict the legal effect of these choices." *Nagy* v. *Riblet Products Corp.*, 79 F.3d 572, 576 (7th Cir. 1996); *see also* Restatement (Second) of

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[2] Indeed, as this Court observed in *Shaffer* v. *Heitner*, 433 U.S. 186, 215 n.44 (1977), the internal affairs doctrine emerged not from any "perceived interest of the State of incorporation," but from the need for certainty in corporate decisionmaking.

Conflicts § 302, cmt. e at 309 ("Uniform treatment of directors, officers and shareholders is an important objective which can only be attained by having the rights and liabilities of those persons with respect to the corporation governed by a single law.").[3]

The "internal affairs" governed by the law of the incorporating state "involve those matters which are peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders." *McDermott Inc.* v. *Lewis*, 531 A.2d 206, 214 (Del. 1987); Kozyris, *Corporate Wars* at 15. A corporate officer's fiduciary obligations fall within this rubric; the courts have consistently held that the fiduciary duties of a corporation's officers and directors are controlled by the law of the state of incorporation. *See, e.g.*, *Cowin* v. *Bresler*, 741 F.2d 410, 414 n.4 (D.C. Cir. 1984) (claims of corporate mismanagement, fraud and self-dealing governed by law of state of incorporation); *Republic Sys. & Programming, Inc.* v. *Computer Assistance, Inc.*, 440 F.2d 996, 997 (2d Cir. 1971) (Medina, J., dissenting) (noting general rule that law of state of incorporation applies to corporation's internal management decisions, and that it is "illogical" to hold officers and directors to varying fiduciary duties in varying jurisdictions).

As petitioners make clear in their petition, the internal affairs doctrine "is not merely a principle of conflicts law. It is also * * * of serious constitutional proportions." *McDermott*, 531 A.2d at 216. The doctrine is grounded in three distinct constitutional protections. First, this Court has ruled

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[3] Commentators have pointed out, moreover, that the current trend is away from, not toward, uniformity among states' corporate laws. *See, e.g.*, P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 Duke L.J. 1, 9 & n.30 (hereinafter "*Corporate Wars*") (citing additional sources). It is thus increasingly important to confirm that only one state—the state of incorporation—may regulate a corporation's internal affairs, as states enact ever more divergent laws and pursue ever more divergent corporate regulatory enforcement.

that under the Commerce Clause, a state has "no interest in regulating the internal affairs of foreign corporations." *Edgar* v. *Mite Corp.*, 457 U.S. 624, 645-646 (1982); *cf. CTS Corp.* v. *Dynamics Corp. of Am.*, 481 U.S. 69, 88-89 (1987) (state does not violate Commerce Clause when regulating internal affairs of its own corporations). Second, while application of the Full Faith and Credit Clause to limit state regulation of the internal affairs of a foreign corporation has been curtailed somewhat since *Alaska Packers Ass'n* v. *Industrial Accident Comm'n*, 294 U.S. 532 (1935) (requiring party bringing full faith and credit claim to establish that interests of foreign state were superior to those of forum state), courts and commentators continue to view the internal affairs doctrine as required by the Full Faith and Credit Clause. *See, e.g., McDermott*, 531 A.2d at 218 ("full faith and credit commands application of the internal affairs doctrine except in the *rare* circumstances where national policy is outweighed by a significant interest of the forum state in the corporation and its shareholders") (emphasis in original); Kozyris, *Corporate Wars* at 34 ("Full faith and credit gives primacy to the statute chosen by the parties with the consent of the state of incorporation.").

Third, the Due Process Clause also requires that corporate officers and directors be given clear notice of the jurisdiction whose laws will govern the corporation's internal affairs. As the Delaware Supreme Court has said, "[w]ith the existence of multistate and multinational corporations, directors and officers have a significant right, under the fourteenth amendment's due process clause, to know what law will be applied to their actions." *McDermott*, 531 A.2d at 216; *see also Draper* v. *Paul N. Gardner Defined Plan Trust*, 625 A.2d 859, 865-866 (Del. 1993).

In the case at bar—in which the Attorney General of *Virginia* charges those who served as officers of a *Maryland* corporation with breach of fiduciary obligations—the trial court applied Virginia corporate law to the foreign nonprofit corporation. *See* Pet. App. 17a-18a (discussing officers' allegedly self-interested transaction and citing *Adelman* v.

Conotti Corp., 213 S.E.2d 774 (Va. 1975); *Kessler* v. *Commonwealth Doctors Hosp.*, 185 S.E.2d 43 (Va. 1971), *Rowland* v. *Kable*, 6 S.E.2d 633 (Va. 1940), and *Deford* v. *Ballentine Realty Corporation*, 180 S.E. 164 (Va. 1935)). Although the court cryptically noted—without citation—that Maryland law was "similar," it was plainly applying *Virginia* law. Pet. App. 18a; *see also* Pet. App. 19a (citing Va. Code Ann. §§ 13.1-909(B) and 55-29). The Virginia Supreme Court affirmed, Pet. App. 12a, and likewise abruptly dismissed petitioners' constitutional objections to the application of Virginia law, asserting that the case did not "involve[ ]" improper meddling by Virginia into the internal affairs of the Maryland corporation. *Id.* at 10a.

The Constitution and this Court's case law forbid this result. Petitioners have argued from the first that their actions were valid under Maryland law. The Virginia courts should have applied that law, not local corporate standards, to petitioners' actions. This Court should grant certiorari to rectify this error and forestall the erosion of the internal affairs doctrine resulting from the Virginia Supreme Court decision.

II. THE PROSPECT OF LIABILITY UNDER VARIOUS FIDUCIARY STANDARDS OF MULTIPLE JURISDICTIONS WILL DETER INDIVIDUALS FROM SERVING NONPROFITS AND IMPEDE INNOVATION.

Nonprofit organizations are created to serve innumerable ends, but the vast majority share a common element: to advance their purposes, they rely heavily on volunteers, or on employees paid on a scale far below the for-profit sector. Nonprofit officers and trustees in many cases also lack the necessary resources to "avail themselves of the services of professional advisers, consultants and experts who typically are at the beck and call of directors and officers in for-profit companies." William E. Knepper & Dan A. Bailey, *Liability of Corporate Officers and Directors* § 12-1(b) (5th ed. 1993) at 463.

If multiple states' standards of fiduciary liability attach to a nonprofit's internal decisions, thousands of capable and dedicated individuals who serve or are considering service to a nonprofit organization will be less likely to commit their time and energy. Lacking both the financial incentive and the expert information to navigate variable standards of liability attaching to their actions, some of those individuals are likely to opt against the risk of personal liability, to the detriment of the nonprofit and our Nation. *See* Note, *Developments in the Law—Nonprofit Corporations*, 105 Harv. L. Rev. 1677, 1682 n.31 (1982) ("Just the *perception* of increased exposure to liability discourages individuals from engaging in charitable activity") (emphasis in original); Charles R. Tremper, *Reconsidering Legal Liability and Insurance for Nonprofit Organizations* 166-167 (1989) (summarizing surveys detailing detrimental effects liability problems had on nonprofit organizations and the organizations' individual actors). [4]

The threat of multiple liability based on varying fiduciary standards will not only steer able people away from nonprofit service; it will tend to force officers and trustees of nonprofits to adhere to the most severe state governance standards on the books, chilling much-needed innovation and deterring creative decisionmaking. As one commentator has observed, "[p]ersonal liability can reduce willingness among directors and officers to have their organizations fill the roles of innovator and path-finder that have led to some of the

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[4] Congress has recognized that many nonprofit organizations struggle to fulfill their critical commitments due to a lack of volunteers willing to offer their services because of a perceived potential for legal liability. It passed the Volunteer Protection Act of 1997, Pub. L. No. 105-19, codified at 42 U.S.C. § 14501 *et seq.*, to provide protection to volunteers, nonprofit organizations, and governmental agencies against lawsuits based on the activities of such volunteers. *See* 42 U.S.C. § 14501(a)(1)-(2) (noting that "the willingness of volunteers to offer their services is deterred by the potential for liability actions against them," and that many nonprofit organizations, including educational institutions, "have been adversely affected by the withdrawal of volunteers from boards of directors and service in other capacities").

charitable sector's most valuable contributions to society." Charles R. Tremper, *Compensation for Harm from Charitable Activities*, 76 Cornell L. Rev. 401, 442 n.182 (1991).

College and university boards are particularly vulnerable to the threat of multiple enforcement of varying fiduciary standards. Colleges and universities across the country are undergoing a sea change, as new technological advances make it possible for institutions of higher learning to establish outpost "campuses" in distant cities and states.[5] These alternative methods of education, whether in the form of a small branch campus serving a few dozen students or an Internet connection to a seminar website, are a salutary addition to traditional campus-based learning. The number of students seeking college degrees is increasing dramatically, *see* United States Dep't of Education, *Back-To-School Report* (1997), and adult professionals are returning to college by the thousands.[6] Institutions of higher education employ innovative techniques, such as the branch campus or

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[5] *See* Paul Cox, *Cyberdegrees: Who needs a college campus? Just log in and start studying*, The Wall Street Journal, Nov. 17, 1997, at R26 (over 400 colleges and universities offer accredited distance-learning programs); Jerry Nachtigal, *Non-traditional School Serves Working Students*, Chicago Tribune, Jan. 26, 1997 (University of Phoenix maintains three dozen branch campuses in eleven states and Puerto Rico); Lynn Van Matre, *Missouri College's Gurnee Shortcut School Branch, Hundreds of Miles from Columbia, a Hit with Older Students*, Chicago Tribune, Nov. 8, 1996 (noting that Columbia College of Missouri, founded in 1851, has established nearly two dozen branch campuses throughout the United States); Mark Robichaux, *Big Thinker: A Fan of Bagpipes and Dragons Wants To Extend Your Mind*, The Wall Street Journal, May 26, 1995, at A1 (describing dozens of university programs offered over cable television to students nationwide).

[6] *See, e.g.*, Dana Hawkins & John Sides, *Older Students Make Their Mark*, 117 U.S. News & World Report 12 (Sept. 26, 1994) (noting that 42 percent of college students are over age 24, and that the National Center for Education Statistics predicted a 17 percent increase in enrollment of adults 25 years and older over the next decade).

website seminar, to reach the thousands of constituents returning to school from the working world or "attending" school part-time. As technological advances foster further innovation, colleges and universities are finding new ways to employ cutting-edge technology together with a wide range of course offerings to create a new and exciting mode of learning. *See, e.g.*, Laura KossFeder, TIME Select/Business Report, TIME Magazine, July 20, 1998 (noting inauguration of Western Governors University, a collaboration among eighteen Western states offering continuing education courses and associate degrees worldwide, via the Web and satellite television).

The rapid advent of satellite campuses and cyber-classrooms—especially when considered together with the current trend *against* uniformity among individual states' corporate regulatory schemes, *see supra* note 3—suggests that the potential for countervailing state corporate directives applied to colleges and universities will increase sharply as the institutions expand into new fora. If institutions are held to the fiduciary standards not only of their home states, but of each and every state in which they establish a presence,[7] the current innovation in our Nation's system of higher education will suffer. College and university boards, fearing lawsuits predicated on liability standards they would have no reason to foresee, could determine that the risks of expansion into underserved suburban and rural areas of neighbor states are too great, and the promise of affordable and accessible higher education through technological innovation will be compromised. This Court should use this occasion to reaffirm that nonprofit corporations, including educational institutions, may expand their services into new states without fear of exposing their internal corporate decisions to multiple and conflicting corporate laws and policies.

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[7] Several courts have suggested that even a defendant's mere "cyber-presence" in a state, such as through a Web page, confers jurisdiction over the defendant in that state. *See Heroes, Inc.* v. *Heroes Foundation*, 958 F. Supp. 1 (D.D.C. 1996); *Maritz, Inc.* v. *Cybergold, Inc.*, 947 F. Supp. 1328 (E.D. Mo. 1996); *Inset Sys., Inc.* v. *Instruction Set, Inc.*, 937 F. Supp. 161 (D. Conn. 1996).

CONCLUSION

This Court and the lower courts have long held that a corporation's internal affairs are to be governed by the law of the state of incorporation. The Virginia Supreme Court decision is a dangerous precedent. It creates confusion, erodes the long-standing internal affairs doctrine, impedes innovation, and should be reversed.

Respectfully submitted,

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